IN THE

SUPREME COURT OF APPEALS

OF THE

STATE OF WEST VIRGINIA

CAMDEN-CLARK MEMORIAL HOSPITAL CORPORATION,

Plaintiff,

v.

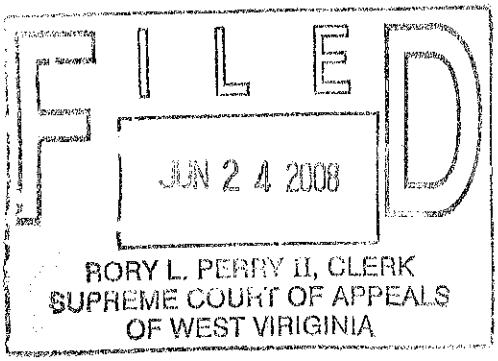
Supreme Court Docket No. 080493

ST. PAUL FIRE AND MARINE INSURANCE CO.,

Defendant.

CAMDEN-CLARK MEMORIAL HOSPITAL CORPORATION'S REPLY BRIEF ON CERTIFIED QUESTIONS POSED BY THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT WEST VIRGINIA

Civil Action No.: 6:06-CV-01013
Honorable Joseph Robert Goodwin, Presiding



Dino S. Colombo, Esq. (WVSB #5066)
Travis T. Mohler, Esq. (WVSB #10579)
Colombo & Stuhr, PLLC
1054 Maple Drive
Morgantown, West Virginia 26505

-and-

Donna S. Quesenberry, Esq. (WVSB # 4653)
MacCorkle, Lavender & Sweeney, PLLC
300 Summers Street, Suite 800
Charleston, West Virginia 25301

Counsel for Camden-Clark Memorial Hospital Corporation

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Treatises

I. INTRODUCTION

A. Summary of Argument

The questions certified to this Court can be summarized as follows: when a verdict is rendered against an insured in an action involving covered and non-covered damages under an insurance contract and the verdict form does not allocate the insured's liability between covered and non-covered damages, does the insured bear the burden of allocation or does that burden lie with the insurer?

Plaintiff urges this Court to adopt a rule placing the burden of proof on the insurance company when a "duty to pay" insurer knows or is aware of the potential for there to be a verdict against its insured for covered and potentially non-covered damages; yet, in breach of its legal duties fails to notify its insured that it will deny coverage unless an allocated verdict is obtained. If this Court holds otherwise, it would be creating a rule that encourages insurance carriers to remain silent in anticipation of an unallocated verdict which would allow them to deny coverage completely, placing the impossible burden of allocation on its paying insured.

Generally, when asked to determine basic coverage disputes under an insurance policy, courts frequently recite the familiar rule that the insured bears the initial burden of proving a prima facie case of coverage, then the burden shifts to the insurer to prove that an exclusion applies. There are circumstances, however, where the burden of persuasion should be placed on the insurer. For instance, if only a portion of the judgment is covered by the policy, a question inevitably will arise as to which party should have the burden of allocating the verdict in order to ascertain the amount of the damages for which the insurer is responsible. *See* 1 Allan D. Windt, *Insurance Claims & Disputes* § 6:27 (5th ed. 2007).

The only treatise that seems to take on this particular issue states that although the burden to prove that a judgment is covered by a policy is usually on the insured, an exception should exist "in those cases in which the circumstances surrounding the defense of the underlying action were such that the insurer was obligated to seek an allocated verdict or advise the insured of the need for one, but failed to fulfill that obligation." *See* Windt, *supra*. This exception is well reasoned.

When a complaint against an insured involves covered and non-covered claims, a divergence of interests arises between insurer and insured. In the face of such a conflict of interests, an insurer is duty bound to inform its insured of that conflict. It it logical that when the insurer fails to so inform its insured, it is equitable to place the burden of allocating a jury's verdict upon the insurer. To hold otherwise would encourage insurers to remain silent until an unallocated verdict is reached and then deny coverage based on a "technical defense" created by its own breach of duty.

Here, St. Paul never forewarned Camden-Clark that it intended to deny coverage if an allocated verdict was not obtained. Notwithstanding the absence of an allocated verdict, St. Paul acknowledges that a large portion of the damages are covered by the insurance policy purchased by Camden-Clark. In fact, even under St. Paul's coverage analysis over seventy-five percent of the compensatory damages are covered. Hence, this is precisely the situation contemplated in the *Windt* treatise. Therefore, this Court should adopt a rule placing the burden of allocation of the entire verdict upon St. Paul.

B. Defendant's Brief Argues Issues Outside The Scope Of These Certified Questions

Defendant's brief confuses the procedural posture of this case and the legal issues before this Court. The parties are before this Court on certified questions from the United States

District Court for the Southern District of West Virginia. These are questions of law. And this Court is not charged with deciding the factual issue of whether coverage actually applies in this case. This Court is only responsible for deciding the certified questions surrounding which party has the burden of proof.

In its brief, St. Paul argues the substance of its coverage positions. While Camden-Clark disagrees with the mischaracterizations and hyperbole contained in St. Paul's brief, such a discussion is not relevant here and will be reserved for summary judgment before the district court. Accordingly, in the interest of brevity, this brief focuses on the legal task before this Court. Discussion of St. Paul's factual arguments, although disputed, will be reserved for the proper time and forum.

II. DISCUSSION and ARGUMENT

A. St. Paul Breached its Duty To Inform Its Insured Of The Need For An Allocated Verdict

St. Paul incorrectly insinuates that insurers as adversaries to their insureds – a characterization unfortunately verified by St. Paul's actions. In its brief, St. Paul alleges that it "had *no duty* to act under the policy and acted appropriately by monitoring the case from afar." *See* Defendant's Brief on Certified Questions, at pg. 21,5 (emphasis added). To the contrary, St. Paul owed Camden-Clark the same duties that are owed by every insurer to its insureds. In West Virginia, all insurance companies licensed to do business in the state are governed by the regulations promulgated by the West Virginia Insurance Commission. These regulations impart certain duties upon insurance companies. For instance, Insurance Regulation 114-14-5.4 provides, in pertinent part:

> Provisions of assistance to first-party claimants. – Every insurer, upon receiving notification of a claim, shall promptly provide necessary claim forms,

> instructions, and *reasonable assistance so that first-party claimants can comply with the policy conditions and the insurer's reasonable requirements.*

W. Va. Code R. 114-14-5.4 (2008) (emphasis added). It follows then that if St. Paul required an allocated verdict to comply with its policy conditions, it had a duty to provide Camden-Clark with the reasonable assistance necessary to do so. St. Paul had every opportunity to intervene or associate in the defense of the underlying matter, but never did. And this is only one of several breached duties St. Paul owed Camden-Clark.

The "Statement of Principles on Respective Rights and Duties of Lawyers, Insurance Companies and Adjusters in the Business of Adjusting Insurance Claims" was adopted January 8, 1939, by the Conference Committee on Adjusters, composed of representatives of the American Bar Association and the insurance industry. Section 4(b) of the Statement of Principles provides that "[i]f any diversity of interest shall appear between the policyholder and the [insurance] company, the policyholder shall be fully advised of the situation . . . ." If the burden of allocating a judgment remains the burden of the insured, as St. Paul argues, then the insurer has an interest in a verdict being ambiguous and unallocated. Based on the insurance industry's own Statement of Principles, St. Paul had a duty to advise Camden-Clark of that conflict of interests, specifically that all coverage would be lost if special interrogatories were not used to allocate the verdict.

In West Virginia, an insurance company also owes its policyholders a duty of good faith and fair dealing. *See Honaker v. Mahon*, 210 W.Va. 53, 62, 552 S.E.2d 788, 797, n.8 (2001) citing *Shamblin v. Nationwide Mut. Ins. Co.*, 183 W.Va. 585, 396 S.E.2d 766 (1990). In accordance with this duty of good faith and fair dealing, in circumstances like the present, a "duty to pay" insurance carrier should be required to advise its insured of the importance of an allocated verdict by special interrogatories and of the likelihood that the insured will bear all

losses without an allocated verdict, even to the extent it has paid for coverage. *See American Home Assur. Co. v. Evans*, 589 F. Supp. 1276, 1288 (E.D. Mich. 1984) (applying Florida law) (holding that the failure to inform the insured of the conflict of interest and availability of special interrogatories is a breach of the duty of good faith and fair dealing and, thus shifting the burden of proof to the insurer).

All of the above duties – the duty of reasonable assistance, the duty to notify of conflicts, and the duty of good faith and fair dealing – were owed by St. Paul to Camden-Clark. In fact, Camden-Clark had paid substantial premiums for those duties. Moreover, those duties apply equally to an insurer who has a duty to indemnify its insured, as it does to those that have a duty to defend. It makes no difference which party hires the lawyer because in West Virginia, the insured is the client, not the insurer. Under a "duty to defend" policy, the insurer is simply paying the attorney's bills – nothing more. These duties are owed by all insurance companies to their insureds. Accordingly, St. Paul's representation that it owed no duty to Camden-Clark is indefensible.

St. Paul also attempts to distinguish the cases cited in Plaintiff's brief based on the premise that those cases dealt with "duty to defend" insurance contracts, opposed to a "duty to pay" insurance contract. As discussed above, the only difference between the two types of insurance contracts is that a "duty to defend" insurer is responsible for paying the legal fees. That minor difference, of course, does nothing to alter or reduce the duties owed by a "duty to pay" insurer to its insured. Despite St. Paul's contrary contentions, St. Paul owed Camden-Clark the above-described duties and failed to satisfy any of them. Therefore, the burden of allocating the verdict post-judgment should rest with St. Paul.

B. The Cases Cited By St. Paul in its Brief are Distinguishable and Not Relevant to These Certified Questions

In its brief, St. Paul cites several out-of-state cases – *Reynolds, Gordon, Morris, Clark,* and *Yancey*[1] – arguing that those cases stand for the proposition that the burden of allocating a mixed verdict is on the insured. However, it is clear that these cases have no bearing on these certified questions. Each case involves an injured third-party seeking to recover under a tortfeasor's insurance policy in a garnishment action after the plaintiff/third-party obtained a judgment against the tortfeasor. These cases cited by St. Paul are not helpful or informative on these certified questions, as it is obvious that no insurance company owes any duty to inform the third-party suing its insured of the need for an allocated verdict.

Under that scenario, the trial court simply applies the general rule that the burden begins with the insured and then shifts to the insurer when an exclusion is invoked. In that situation, it is logical to conclude that the burden of allocation should not be shifted from the third-party to the insurance company because it owed no duty to the third-party. In that situation the insured should be responsible for paying the entire judgment. The insured would then be entitled to file a declaratory judgment action against its insurer wherein the burden of proof would be on the insurer.

None of the cases cited in Defendant's brief involve such a policy provision. Accordingly, the holdings in *Reynolds, Gordon, Morris, Clark* and *Yancey* are all irrelevant to these certified questions because Camden-Clark is a first-party claimant which already satisfied the judgment.

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[1] See Defendant St. Paul's Brief on Certified Questions, at pg. 18; *Universal Underwriters Insur. Corp. v. Reynolds*, 129 So. 2d 689 (Fla. Dist. Ct. App. 1961), *Md. Cas. Co. v. Gordon*, 52 Tenn. App. 1, 371 S.W.2d 460 (Tenn. Ct. App. 1963), *Morris v. Western States Mut. Aut. Ins. Co.*, 268 F.2d 790 (7th Cir. 1959), *Gen. Accident Fire & Life Assurance Corp. V. Clark*, 34 F.2d 833 (9th Cir. 1929), and *Yancey v. Utilities Ins. Co.*, 23 Tenn. App. 663, 137 S.W.2d 318 (Tenn. Ct. App. 1939).

The case of *Duke v. Hoch*, 468 F.2d 973 (5th Cir. 1972), cited in Plaintiff's principal brief, demonstrates the only circumstances under which a third-party claimant would have standing to assert the insurers failure to notify the insured of the divergence of interest caused by an unallocated verdict as justification for placing the burden on the insurer. *Duke* involved a policy provision that provided that any person who secures a final judgment against the insured is entitled to recovery under the policy to the same extent as the insured. *See Id.* at 983. The Fifth Circuit ruled that under this provision, the third-party was entitled to assert the rights of the insured.

St. Paul also cites *Golden Eagle Refinery Co, Inc. v. Associated Int'l Ins. Co.*, 85 Cal. App. 4th 1300 (Cal. Ct. App. 2001) for the proposition that the burden of allocation rests with the insured. *Golden Eagle* is also irrelevant to these certified questions because it deals with an insurance company and its insured debating what event caused environmental contamination to the insured's land rather than an unallocated verdict or judgment. This is a much different set of facts than the scenario presented in these certified questions.

In fact, *Golden Eagle* was heavily relied on by the insurance company and rejected by the Delaware court in *Premiere Parks v. TIG Ins. Co.*, No. 02C-04-126-PLA, 2006 WL 2709235 (Del. Super. Sept. 21, 2006) (unreported) ("*Premiere Parks III*"). The court in *Premiere Parks II* easily distinguished *Golden Eagle* saying that it "is distinct in that it discusses the shifting of the burden to allocate between insurer and insured in the context of a California Code of Civil Procedure provision." *Premiere Parks II*, 2006 WL 2709235, at *11. Further, the court in *Premiere Parks II* found that:

> It is also dissimilar to the facts in this case in that the insured in *Golden Eagle* entered into a consent order with the State of California in which it agreed to remediate the toxic contamination at the insured's refinery. The insured, however, did not seek indemnification from its insurer for the clean up costs until almost

> five years after the insured completed the clean up. The court held, in part, that because the insurer had no knowledge of its insured entering a consent order with the state and was not aware of its insured's clean up activities, it should not have the burden of proving what caused the contamination - "sudden, unintended and unexpected events" (covered under the policy) or "routine, repeated and intentional release" of contaminants (non-covered events). The court, therefore, placed the burden on the insured to make such a showing.

Id.

The court in *Premiere Parks II* held that "if the burden always remained with the insured under these circumstances, as TIG would have the Court rule, then the insurer could consistently rely on a 'technical defense,' giving it 'an easy opportunity to prejudice the rights of the insured by just allowing a general verdict, [or settlement,] and then requiring the insured to prove which damages were covered.'" *Id.* at *12. Therefore, the *Golden Eagle* case is as irrelevant here as it was in *Premiere Parks II* and should be disregarded.

St. Paul also cites *Raychem v. Federal Ins. Co.* for the proposition that the initial burden to show allocation should be on the insured. *Raychem* places the initial burden on the insured in the context of a corporate directors and officers (D&O) policy and contains very little analysis or reasoning for its decision. Moreover, the court recognizes that "[s]ome courts have held that the burden is on the *insurer* to demonstrate to what extent a settlement of a lawsuit against directors, the corporation and a third party must be allocated to the corporation and third party . . ." *See Raychem Corp. v. Federal Ins. Co.*, 853 F.Supp. 1170, 1175 (N.D. Cal. 1994) (emphasis in original). Nonetheless, the court decided that based on the particular facts of the *Raychem* settlement and the particular D&O policy-specific issues, the insured should bear the initial burden in this case. The court in *Raychem* did not discuss or distinguish any of the cases cited in Plaintiff's original brief that shift the burden to the insurer under circumstances like the present

case because it dealt with issues exclusive to D&O policies. Therefore, *Raychem* should not be read to apply outside of the D&O policy context.

C. It Is Not Necessary For The Trial Court To Extract From the Record What Was In the Mind of the Jurors When They Awarded Damages

After citing the above-discussed irrelevant case law, St. Paul attempts to hedge its bets by arguing that "whichever way the Court chooses to find regarding the burden of proof, . . . if the trial court can properly extract from the record what should have been the proper allocation of damages by the jury, it should do so." *See* Defendant's Brief on Certified Questions, at pg. 20. Certainly, it should not be the trial court's responsibility to determine what was in the juror's minds when they decided damages in a case. To the contrary, this is why the law has burdens of proof – because it is one party's responsibility to demonstrate sufficient facts to prove that a certain thing is what that party claims it to be. It is not the court's duty. And in any event, the issue of determining what conduct was considered in the jury's verdict is an issue for summary judgment before the district court.

The cases cited in Defendant's brief in support of this allegation do not support Defendant's position. The first case upon which Defendant relies, *Commercial Union Ins. Co. of NY v. Reichard*, 404 F.2d 868 (5th Cir. 1968), did not address the issue of allocation. In *Reichard*, the court held that it was not possible for the jury to have awarded damages for negligent hiring (non-covered) because the jury was only instructed as to vicarious liability (covered damages). *See Id.* at 869-70. Indeed, the court stated "that if the jury could have based its verdict for punitive damages on either the vicarious liability of [the employer], or [the employer's] own misconduct, it would be impossible to determine from this verdict which

produced the verdict. It would then be necessary to determine whose burden it was to prove the impossible." *Id.* at 869.

The court determined that this was not a matter of allocation because there was only one possible basis for liability. Therefore, if the *Reichard* case stands for anything, it is that whichever party bears the burden of allocation, bears an impossible burden. This is all the more reason to encourage insurance companies to inform their insureds of the peril that an unallocated verdict will bring.

St. Paul also cites *In re: Feature Realty Litigation* for the argument that the burden of allocation is on the insured and the trial court must allocate the judgment for the parties if possible. This case simply holds that "[i]n Washington, the general rule is if a judgment or settlement includes several claims, some of which are covered and others of which are not covered, allocation of the judgment or settlement is allowable where there is a reasonable means of doing so." *In re: Feature Realty Litigation*, 2007 WL 2156605, at *7. While allocation of a judgment should always be presumed permissible when there is a reasonable means of doing so, it is the insurer that should bear that burden under circumstances like the present.

III. CONCLUSION

In response to the certified questions, the better rule places the burden of proof on the insurance company when it fails to forewarn its insured that all coverage will be denied unless an allocated verdict is obtained. By placing this burden on the insurance company, it is more likely to intervene in the underlying action to pose special interrogatories, thus avoiding expensive and time consuming post-judgment coverage litigation. Otherwise insurance companies will have an incentive to delay allocation of a verdict until after judgment is entered.

Defendant has failed to cite one similar case where the underlying litigation resulted in an unallocated verdict and the court put the burden of proof on the first-party claimant; yet, that is what it asks this Court to hold. On the other hand, Plaintiff has cited multiple cases from several jurisdictions that place the burden on the insurer in circumstances like the present case. Therefore, based on the foregoing reasons, Plaintiff respectfully requests this Court to hold that the burden of allocation is on the insurer in circumstances like the present case.

Respectfully submitted,

Dino S. Colombo, Esq. (W.Va. Bar # 5066)
Travis T. Mohler, Esq. (W.Va. Bar # 10579)
Colombo & Stuhr, PLLC
1054 Maple Drive
Morgantown, West Virginia 26505

-and-

Donna S. Quesenberry, Esq. (W.Va. Bar # 4653)
MacCorkle, Lavender & Sweeney, PLLC
300 Summers Street, Suite 800
Charleston, West Virginia 25301
Counsel for Camden-Clark Memorial Hospital Corporation

CERTIFICATE OF SERVICE

I, Dino S. Colombo, counsel for Camden-Clark Memorial Hospital Corporation, do hereby certify that service of the attached "Camden-Clark Memorial Hospital Corporation's Brief on Certified Questions Posed by the United States District Court for the Southern District of West Virginia" was had upon the persons listed below by filing true copies thereof on this 24th day of June, 2008 in the United States mail, postage prepaid, addressed as follows:

D.C. Offutt, Jr., Esquire
Perry W. Oxley, Esquire
David E. Rich, Esquire

OFFUTT & NORD
949 Third Avenue, Suite 300
Post Office Box 2868
Huntington, West Virginia 25728-2868

Counsel for Defendant, St. Paul Fire and Marine Insurance Co.

/s/ Dino S. Colombo

Dino S. Colombo, Esq.